The Paris Club and African Debt*

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Origins and Evolution

It will be helpful to start with an institutional account of the Paris Club, because there is relatively little written about it, and much misunderstanding. In origin, the so-called Club goes back 34 years, to the Argentine debt settlement of 1956. Indeed, the Club celebrated its 30th Anniversary in 1986 with a splendid dinner at the Banque de France. But the 1956 negotiations were very different from the present system. The background was, of course, non-convertibility. And the Argentine negotiations concerned the speed with which blocked accounts would be freed up. Thus the problem was essentially the same: a lack of hard currency resources to meet existing obligations. But the financial framework was completely different. Some of the intellectual approach, and indeed the language of the present-day Paris Club agreements reflects these early origins. Above all, it was a multilateral solution to the problem. One of the contemporary documents on Treasury files puts it very clearly:

> It would be surprising if the Argentines abandon their preference for bilateral discussions. Our proposals for a roundtable conference clearly alarmed them. They prefer to negotiate bilaterally in the belief that the lessons learned in one encounter may be applied to good effect in the next. The prospect of sitting down with representatives of high technical competence from several countries together is not calculated to attract them in their present situation. They are afraid of being manoeuvred into uncomfortable positions and of being faced with unpalatable decisions. This is, I think, the chief reason why they counter our proposals with plausible arguments that the disparate nature of their debts and the dissimilar preoccupations of their creditors make a joint examination of this problem impracticable.

The pattern which was established for Argentina in 1956 has served the financial community well ever since, and I think the debtors now accept that.

During the 1970s, the pattern of multilateral government debt negotiations became relatively standardised. But there was a significant shift over time. In 1972 and 1974, there were two major debt reorganisations involving Ghana and Indonesia (the latter the result of the plan formulated by Hermann Abs). These agreements were on a very long timescale — 30 years I believe — and at concessional interest rates. It is interesting that the lenders (primarily but not exclusively aid agencies rather than export credit agencies) apparently absorbed the implicit costs of concessional interest rates without a murmur. Later in the 1970s as a number of African countries, 10 years or so after independence, began to run into payment problems — many of them the result of early economic mismanagement as much as malign external conditions — the practice grew up of the major creditors meeting together regularly but informally. Nearly all of them were members of OECD and the meetings were almost always under French chairmanship. There were one or two exceptions: for example, Britain chaired one of the later Ghana debt conferences, and the negotiations with Turkey, itself an OECD member, took place there rather than in the strictly Paris Club format. Many of these negotiations still centred on old aid loans, although the UNCTAD resolution 165 of 1979 recommended the progressive conversion of such loans into grant — the process known as RTA. Partly as a result of that, and partly as a result of the changing pattern of indebtedness, the focus has shifted from the early 80s onwards towards export credit debt — that is, loans made directly, by bodies like US Exim, or guaranteed by bodies like ECGD. Nearly all such lending was on commercial terms (though much of it was at slightly concessional rates, as defined by the OECD consensus). From 1982 onwards, the major debtors moved centre-stage, but the path had been laid down for them by Poland, which went to a Paris Club procedure (diplomatically given a different name) in 1981.

Since then, the sausage machine has become highly automated, and negotiation follows a fairly standard pattern with surprising speed. The Secretariat recently produced some startling figures to demonstrate the scale of these operations. In 1987 alone, the total volume of payments rescheduled amounted to $26 bn. Even if you subtract Poland and Yugoslavia, we rescheduled $18 bn of debt of 15 developing countries. That is $2 bn more than the total gross disbursements of the World Bank (including IDA) and of the IMF. It represents an enormous contribution to easing the

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immediate cashflow problems of the debtors. And it only involved 17 meetings, each one or two days long, plus a few informal technical meetings among the creditors. Contrast this with the weeks spent by the banks on each case.

Main Features of a Paris Club Agreement

How does the Paris Club operate? Perhaps the easiest way to understand it, and the rationale behind it, is to analyse the main features of an Agreed Minute — the formal process-verbale which records the decisions of a meeting. In form, this is simply a recommendation to creditor governments by their representatives meeting in Paris informally under French chairmanship. To give legal force to these recommendations, they have to be translated into a series of binding bilateral agreements. Those signed by the UK, though not all the others, actually take the form of international treaties registered at the United Nations. Many others are simply an 'exchange of letters'.

The Agreed Minute begins with a recital of the countries and international organisations attending the meeting, and of the fact that they listened to a presentation by the debtor of his serious financial position. The formal and slightly stilted language conceals an important truth: that the creditors meet with the debtor under the shadow of a threat of imminent default, in order to provide a tidy and mutually-acceptable solution rather than an untidy and acrimonious default. This criterion of 'imminent default' goes right back to the Argentine agreement (and indeed, probably to pre-war days). The same paragraph solemnly takes note of the determined efforts being made by the debtor to put his house in order. This too has long-standing historical antecedents. But its purpose, these days, is to provide a peg on which to hang a reference to an IMF-approved adjustment programme.

The Agreed Minute then proceeds to define the debt covered by the agreement. In practice this is very important. First of all, it almost invariably excludes short-term debt. This means that export credit agencies can go on providing short-term cover, secure in the knowledge that this at least will be serviced and turned over freely. The debtor country is able to go on financing part of his imports, including vital food and spare parts, on ordinary commercial credit terms without having to put up immediate front-end cash. The major exception to this rule was Nigeria, who built up enormous short-term arrears in 1983 which subsequently had to be rescheduled — in effect, capitalised and spread over the medium-term. It is a precedent we are very anxious to avoid repeating. So the debts which are covered by the agreement are medium and long-term, a mixture of some old aid loans (if not covered by RTA already) and a lot of export credit. Inter-governmental loans other than aid are very rarely included, though I can think of a few cases. Very often, these debts are sub-divided into arrears built up on recent maturities; new maturities; and arrears or new maturities of previously rescheduled debt (known in the trade as PRD). All those are defined in relation to contracts entered into not later than a certain date, known as the 'cut-off' date. This too has an important strategic significance, much insisted on by the IMF. The theory is that if a debtor country is forced to reschedule a second or third time, the cut-off date will not be moved — i.e. credit agencies can go on lending to the debtor even after rescheduling, once again secure in the knowledge that such new loans will be exempted from further rescheduling. In fact, ECGD introduced a new facility in 1985, the so-called DX facility, specifically to cover such cases, and the Chancellor made rather a virtue of it at the Interim Committee meeting of October 1985.

Having defined the debt to be covered, the minute goes on to set out the proportion to be rescheduled — ideally, about 85 per cent of principal and no interest, but often, in practice for the poorest countries, 100 per cent of both. (I should note at this point that while the banks do not reschedule interest, the Paris Club does. Such rescheduling is sometimes the financial equivalent of the 'new money' increasingly rarely being provided by the banks. More usually the banks continue to receive their interest, while the government creditors reschedule part or all of theirs, thus increasing their exposure both absolutely and relative to the banks.)

Then the minute goes on to set out the terms of such rescheduling — the grace period, the new repayment schedule, and the timetable for meeting the down payments if any (i.e. the 15 per cent or so which is not to be rescheduled, but which is often spread out over 12 or 18 months). Then the minute specifies that such rescheduled loans shall carry interest at 'the appropriate market rate', to be determined bilaterally. After that, it requires the debtor to seek comparable terms from other creditor governments, and from other institutions (mainly banks, but sometimes also commercial creditors; this was particularly important in the case of Nigeria).

The minute does not specifically say that debt due to the international institutions will be excluded, but there is a tacit understanding that this is so. I imagine the reasons for this exclusion are well understood: it is essentially because the IMF was seen as a revolving fund, whose resources must be preserved and if necessary refinanced from other sources. The IBRD sees it as in the interests of its borrowers that it should continue to obtain the finest possible terms for its own market borrowing, which in turn means that it must be exempted from rescheduling.

The next section of the Agreed Minute deals with conditionality, in a rather back-handed way. It

provides that the agreement continues to have force, so long as the debtor country has an arrangement with the IMF 'in the upper credit tranches' — i.e. a standby agreement. The wording has now been modified to cover SAF and ESAF agreements as well. This clause contains a bit of a nuclear deterrent in as much as, if an IMF agreement lapses we cannot actually afford to invoke the clause, because that would be to push the debtor country back into technical default. It is the whole object of the Paris Club procedure to avoid that. I return to this point in a moment. Then there are some technical provisions to ensure that the different creditor governments are all treated on an equal footing, and that the referee — in this case, the Secretariat — can see fair play; and often there is a goodwill clause committing the creditors to consider in principle a renewal of the agreement if the debt problems continue. The whole thing is set out in rather stilted language, in two versions, English and French. Both are equally unreliable. It is then signed, with a great flourish, by the Finance Minister of the debtor country, and by all the countries round the table.

Proceedings of the Club

So much for the format of the agreement. What actually happens? First of all, there is a good deal of pre-cooking. We do not actually proceed to a negotiation until an IMF programme has been approved (though sometimes pressure of time means that we have to rely on a telegram from Washington to tell us that this has happened). In practice, when the IMF staff endorses an adjustment programme, they have to make assumptions about the amount of debt relief which the different groups of creditors will be prepared to offer. This is a slightly chicken and egg situation, but we get round it by having a monthly round up in the Paris Club of all the debtor countries known to be in the pipeline. By the time we get to a formal negotiation, the IMF have a pretty good idea of how far the creditors are prepared to go. In practice, as I shall demonstrate, the variables in the equation are rather limited. On top of that, there is preparatory negotiation, very informal, between the chair and Secretariat on the one side, and the debtor government on the other, to make sure that everybody understands the figures and the procedure. Failure to do this has on occasion led to an almost complete breakdown of negotiations, with some pretty hair-raising late night cliff-hangers.

The formal part of the proceeding begins with a presentation by the Finance Minister of his country's problems and of its adjustment programme. Some of these presentations are awfully tedious. All the creditors present should have had the details long ago, in the form of the IMF Staff papers presented to the Board, and the better-organised debtors circulate prepared statements a few days before the meeting, often prepared by their private bank advisers. But there is no equivalent procedure to 'reading it into the record' in Congress, and we have to sit through the whole recital. This is followed by short, usually repetitive, statements by the various international institutions. These are often in inverse ratio to their importance. What everyone listens for, of course, is the IMF representative. Again, these statements could and should be provided in written form, but we have to sit through them. This process takes up much of the first morning, after which we move into a creditor caucus. The IMF observer usually sits with us for this stage.

The Secretariat prepare a 'payment capacity' table to support this part of the discussion. Usually, this only looks one or two years ahead; the period covered by the consolidation. They also prepare a Tableau Magique, with each of the main parameters of the agreement along one axis, and the names of the creditor countries along the other. Filling this in automatically indicates the lowest common denominator of agreement, and since the Club always proceeds by consensus, one can see at a glance what the opening offer is likely to be. The chair tries to formulate this fairly, perhaps involving some bargaining if one or more creditors holds out from the consensus. Then this is put to the debtor country — often over the lunch break on the first day. Then follows a period of shuttle diplomacy, more or less protracted according to the difficulty of the operation. The chairman moves from the debtors' room at the back of the building to the main conference room where the creditors remain assembled. If the proceedings are more than usually protracted, the chairman sometimes allows time off for dinner. Sometimes the procedure is drawn out over more than one day, in order to give the debtor government time to consult its authorities at home. Usually, the creditors have plenipotentiary powers already. Finally, settlement is reached, and the formal documents are signed. A polite speech is made on both sides, and appropriately these pay tribute to the creditors' generosity. There is then a bland press statement, which contains none of the serious material of the negotiation. After that, the process becomes one of bilateral negotiations, sometimes spread out over the next six months. Notably this process puts a considerable strain on the organising ability of an underdeveloped African country.

Finally, it is worth noting one difference between our procedures and those of the banks. The Paris Club does not negotiate new-money packages (though when it reschedules interest it does provide equivalent relief). We try to avoid being drawn into multilateral pledging sessions, leaving that to be organised in the donor groups convened by the World Bank.

There are a number of points worth bringing out

about this procedure. One is the key role played by the chair and the Secretariat — full-time officials of the Direction du Tresor, part of the Ministry of Finance roughly equivalent to the home and overseas finance sides of the British Treasury. The chairman of the Paris Club is the Directeur du Tresor himself, Jean Claude Trichet. His immediate deputy, the Chef de Service Internationale (in British terms a Deputy Secretary) also spends a great deal of time and effort on this work, as does his immediate subordinate, the Sous-Directeur responsible for bilateral affairs and African countries. The more important national delegations are also headed at senior level: the Americans, by a Deputy Assistant Secretary from the State Department; the Canadians, by my opposite number in the Finance Ministry there; the Germans, at the same level from the Economics Ministry, and so on. Note that some governments are represented by the Foreign Ministries, others by Finance or Economics Ministries. But they all have plenipotentiary powers from their governments. The Export Credit Agencies (in most countries public corporations rather than a government department as in England) are represented by observers. So are some central banks. The individual creditors meet informally from time to time, and keep in touch between meetings by telephone and telex. The name Paris Club is not entirely a joke. The 17 or 18 heads of delegations all know each other pretty well by now, and are on first name terms. We dine together for a working session once a month. The informal contacts at and between meetings play an important part in the way the operation works. Most importantly, in my view, is the fact that the whole operation is run by a single national administration, and a highly professional one. There are none of the problems one has with an autonomous international Secretariat trying to carve out a role for itself. Nor, to be fair, do the French abuse their position in favour of francophone African client states. They exercise a genuinely neutral role, and do it with enormous professional skill.

Some Current Issues

Let us move from this formal account to some of the issues raised by the Paris Club's present modus operandi. The first and most important point, and certainly the most controversial, is conditionality. These days it is a golden rule of the Paris Club that we will not consider rescheduling without an IMF programme in place. There is a limited category of countries, not currently IMF members, or newly admitted, for which different procedures have been evolved. I think I helped to evolve them, in the leading case of Poland a few years ago. We were anxious to ensure conditionality, and to make certain that creditors were not wasting their money when they agreed to reschedule on generous terms. But there was no IMF to appraise the Polish economy for us, or to suggest terms. We tried to do it for ourselves. We set up a small task force, of the four or five major creditors, and paid a number of visits to Warsaw for direct contact with the different Ministries there, in an attempt to work out a pattern. To be frank, it did not work well. We had neither the skills, nor the supporting staff, of a typical IMF mission. We did not know how to translate IMF conditionality, with which we were reasonably familiar, into the terms of a centrally-planned economy as Poland then was. Nor could we grapple with the very idiosyncratic Polish official statistics. With a sigh of relief, we handed the job over to the IMF when Poland rejoined. We used slightly similar tactics for Mozambique before that country joined the IMF. The results have not been very satisfactory. Normally, we have insisted upon a standby agreement, though in three recent cases we have started with an SAF. Increasingly, I think, we shall see longer-term agreements, under the SAF and now the ESAF, forming the basis of Paris Club operations, possibly for coterminous lengthened consolidation periods. We have considered, but not so far accepted, the idea of agreements based solely on IBRD lending, in the form of an SAL. Perhaps that reflects the feeling of many creditors that IBRD conditionality is not yet as tight as that of the Fund, and there is a tendency in the Club to look at the Fund as its main supporter.

The next point concerns our estimate of the payment capacity of a debtor, and thus the terms of our rescheduling. I noted that the Secretariat produced payment capacity figures for the period covered by the rescheduling — that is, the maturities falling due in the first year or 18 months. They seldom attempt a longer horizon. We all know how difficult it is to draw up projections of payment capacity, based as they are on forecasts of export earnings which are particularly difficult for monocultures like many African countries, and which involve making assumptions about the openness of OECD markets for their exports. It is also extremely difficult to judge the tolerance of the local population to continued austerity, and their willingness to do without imports for all but essential purposes in order to release resources for debt service. So long-term projections are difficult to come by, and not always worth the paper they are not yet written on. However, I think we should look more carefully at long-term debt maturity profiles to avoid the very awkward bunching which we have sometimes imposed on the debtor country. It is going to be very important to look at the combined impact of repayments due to the banks, to the IFIs and to the Paris Club creditors.

Another set of problems concerns the simplification of our procedures. Look at Zaire, which has rescheduled nine times in the last 12 years. Each consolidation was done on slightly different terms, and several of the

agreements have been re-rescheduled two or three times. The result is a multiplicity of separate categories of debt, often involving comparatively small percentages of percentages of percentages. There is a case for rolling all the existing stock of debt together in one ball, and reconsolidating the lot over a longer timescale, to achieve a more realistic repayment schedule. We have done something like this, experimentally and particularly for one country — Poland — and I hope we shall be able to do more. The problem is to do so in ways which preserve parity of treatment between different groups of creditors.

Another thing we ought to do is to simplify and speed up the process of signing bilateral agreements, which can be terribly time consuming for the debtor governments concerned. Maybe a standardised agreement form would help, but different national legal systems and different institutional arrangements among the creditor countries make that hard to achieve. There are in fact only two main points left open for bilateral agreement — the actual list of debts concerned, and the 'appropriate market interest rate' to be charged. The first has obviously to be handled bilaterally. The second means finding a rate which avoids a continuing loss to the Export Credit Agency concerned — i.e. it has to cover its own cost of funding. So far we have not found an internationally-agreed formula to define this multilaterally in advance. The result is to leave room for much time-consuming bilateral negotiation afterwards, with very small savings to the debtor at stake. Another possibility is to revive the idea of multi-year rescheduling agreements. (I think it was I who coined the acronym MYRA for these, in the context of an early Yugoslav agreement.) The early experiments were not very successful. We were probably too precise in trying to set down conditions in advance. We are now looking again at procedural changes which will allow us to give the debtor country some assurance of continuity, while reserving the levers of conditionality in the hands of the creditors.

Conclusions

To sum up: the international debt problem, looked at from the viewpoint of the creditors, is primarily a matter for the banks, and only secondarily for the government creditors. The government creditors are proportionately more important in Africa than in Latin America and elsewhere. Some mechanism is essential to ensure the orderly restructuring of intergovernmental debt. By a series of historical accidents, the Paris Club has evolved into that mechanism. It is in fact an extremely efficient instrument for the purpose, processing very large volumes of debt with remarkable speed and lack of friction. It can do so because it relies upon the IMF to enforce appropriate conditionality, to protect the creditors' long-term interests. Its procedures may look a bit odd, but each element has its historical and current rationale. Some further improvements are no doubt possible, and we are looking at them. The Club regard themselves as a pretty hard nosed group of debt-collectors. But they also recognise that their operations serve an essential developmental role, by removing one of the inhibitions to future development. Increasingly they see their operations in that context, and have evolved their procedures to fit.

Postscript

Since this paper was prepared, in May 1988, there have been several new developments. The most important was the decision of the Toronto Summit of the seven major industrialised countries, in June that year, to soften the terms of rescheduling applied to the very poorest and most heavily-indebted countries. This decision followed an initiative launched by Nigel Lawson, when Chancellor, in April 1987. Creditors choose from a menu of options, including cancellation of one-third of the debt (as proposed originally by President Mitterrand), reducing interest charges so as to bring down the net present value by about one-third, or rescheduling over much longer periods. So far 13 countries, mainly in Africa, have benefited from the new 'Toronto Terms', one of them for two years running. Two others have been given extended repayment periods. In another development, the Club agreed to base rescheduling in appropriate cases on a 'Fund-monitored programme' rather than on a conventional Stand By. (These programmes are being developed for countries which are seeking to escape from the Catch-22 of large arrears to the IMF which make it impossible for the Fund to grant a normal Stand By immediately; such countries desperately need debt rescheduling as a precondition of recovery yet would not qualify for it if the Club continued to insist on a Stand By.) Finally, the Club is now paying very close attention to 'comparability of treatment' between government and banking creditors. As explained, the practice of the Club in rescheduling interest has led in many cases to a big increase in its exposure relative to that of the banks. And at the same time the International Financial Institutions have tended to increase theirs. This progressive transfer of risk from the private to the public sector has gone too far (as the Interim Committee of the IMF noted at its April 1989 meeting). So the Club is no longer prepared to be treated as 'financier of last resort', it increasingly limits its own debt relief packages to what it considers to be its own fair share of the total burden carried by all creditors, thus putting the responsibility upon the banks to make their own contribution or risk facing a default.